

Internal Revenue Service

Number: **200730016**
Release Date: 7/27/2007
Index Number: 1362.04-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B1
PLR-152479-06
Date: April 19, 2007

Legend:

A =

X =

Y =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Month =

Dear :

This letter responds to your letter dated November 2, 2006, and subsequent correspondence, on behalf of X, requesting relief under section 1362(f) of the Internal Revenue Code.

Facts:

According to the representations submitted, X elected under § 1362(a) to be an S corporation effective Date 1. On Date 2, X issued shares to Y, an individual retirement account (“IRA”) for the benefit of A. X represents that it did not realize at the time of the transfer that Y was not an eligible S corporation shareholder. In Month, the accountant preparing X’s Form 1120S for the year ending Date 3 alerted X to the fact that Y was not an eligible shareholder. On Date 4, A purchased the X shares, individually, from Y.

X is requesting a ruling granting relief under § 1362(f) for an inadvertent termination of its S corporation election as a result of an ineligible shareholder, Y, acquiring stock of X. X represents that the transfer of X stock to the IRA was not motivated by tax avoidance or retroactive tax planning. X also represents that at all times it has acted and filed consistently with its belief that it was an S corporation effective Date 1. Specifically, A reported Y’s share of income on A’s federal income tax return. Furthermore, X and A both treated A as the owner of X stock. X and its shareholders agree to make any adjustments, consistent with the treatment of X as an S corporation, which the Secretary may require.

Law and Analysis:

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a “small business corporation” for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that an S corporation cannot have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Rev. Rul. 92-73, 1992 C.B. 224, holds that a trust that qualifies as an individual retirement account under § 408(a) is not a permitted shareholder of an S corporation under § 1361.

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by an corporation was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in termination, steps were taken so that the corporation is once more a small business corporation, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make any adjustments

(consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

Conclusion:

Based solely upon the facts submitted and the representations set forth above, we conclude that X's S election terminated on Date 2 when Y, an ineligible shareholder, acquired X stock. We also conclude that the termination of X's S election constituted an inadvertent termination within the meaning of § 1362(f).

Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 2 and thereafter, provided that X's subchapter S election was valid and was not otherwise terminated under § 1362(d).

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the above-described facts under any other provision of the Code. Specifically, no opinion is expressed on whether X is or was otherwise eligible to be an S corporation.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Audrey W. Ellis
Senior Counsel, Branch 1
Office of Associate Chief Counsel
Passthroughs & Special Industries

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes